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Statement of the National Association of Independent Insurers to the Commissioner of Financial and Insurance Services Regarding the Use of Credit Information by Personal Lines Insurers

My name is Jeffrey Brewer and I am with the National Association of Independent Insurers. NAII is a national trade association and we represent nearly half of the property and casualty insurers in the state of Michigan.

The use of credit information has been permitted since 1970 when the US Congress passed the Fair Credit Reporting Act. While the practice has been permitted for over 30 years, it is new for some insurers and has become more widely used in recent years.

Before we move on – it is important to clarify the distinction between a credit score and an insurance score. Simply put a credit score looks at credit-related information to predict the likelihood of a person paying back consumer debt. On the other hand, an insurance score is used to predict the likelihood of an insurance loss.

An insurance score is developed from a mathematical model that weighs and measures credit information such as the number of collections, bankruptcies, outstanding debt, length of credit history, types of credit in use and the number of new applications for credit. These factors identify credit management patterns that have been proven to correlate with the probability of an insurance loss. This is a tool that helps to assess risk.

Insurers are interested in having available as many tools as possible to assist them in making objective decisions about whom to insure and at what rate. Insurance scores provide insurers another tool to use in making sound rating decisions. Bear in mind, most companies use insurance scoring as just one of several factors. It helps insurers develop a more complete picture of the likelihood of someone filing a claim. It provides insurers with an objective tool for decision-making that evaluates risk and allocates the cost of coverage based on a consumer's insurance loss potential.

Independent studies have proven a strong connection between insurance scores and the likelihood of an insurance loss. A Tillinghast-Towers Perrin study demonstrated that there was a 99 percent probability of a relationship between insurance scores and the likelihood of an individual filing an insurance claim.

Studies by Arthur Andersen and the Insurance Research Council show that credit reports are more reliable than motor vehicle records. In addition, consumers have a clearly defined review process to ensure the accuracy of their credit report.

In January 2000, the Virginia Bureau of Insurance released a study that concluded that insurance scoring is an accurate predictor to assess insurance risks and that neither income or race alone is a reliable predictor of credit scores thus making the use of insurance scoring an ineffective tool for redlining.

Most people have good credit and can benefit from insurance scoring. It can help consumers qualify for lower insurance rates. The use of insurance scoring helps insurers more accurately allocate the cost of insurance and prevent people who pose less risk from subsidizing high-risk policyholders.

Insurance scores do not discriminate against any specific group of customers. Insurance scores of people in lower income levels are virtually the same as those in higher income groups. They avoid subjective value judgments. The development of an insurance score only takes into account credit-related information and does not consider race, gender, religion, marital status, income and birthplace.

They provide an indication as to how responsibly a person manages whatever amount of income he or she makes. We believe this ability to manage risk may carry over to other areas of their lives.

One NAII member found that using insurance scores enables it to charge 70 percent of its customers lower premiums. Other NAII members confirm that the use of credit has allowed them to write more business in urban areas.

Insurers do not use insurance scores to determine a person's ability to pay premiums. Insurance companies use an insurance score to assess an individual's insurance risk at a particular point in time.

The ability of insurers to make sound rating decisions also helps keep the insurance marketplace competitive.

Michigan is currently one of the most restrictive states when it comes to insurers' use of credit scores. Michigan's insurers can not use credit for underwriting decisions even though most other states do permit it. And in rating, Michigan insurers can only use credit to discount premiums. Is it good public policy to take this potential discount away from consumers?

Banning the use of credit for rating purposes would truly be a disservice to Michigan consumers by forcing good risks to subsidize bad risks. Michigan insurers merely desire to charge policyholders the appropriate amount for the risk they represent. It has been proven time and again by insurers data analysis as well as independent studies that an insurance scores bear a relationship to the likelihood of insurance losses. There have been extensive studies on risk taking behavior and the correlation is solid.